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**German Economic Issues**  
**An Informed Questions Paper**

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## **German Economic Issues**

### **An Informed Questions Paper**

#### **Demographics**

If Germany's birth rate remains at its current level, the population will decline from 82 million to less than 60 million in the next 50 years. "Over the same period, employment figures will drop from 41 million to just 26 million. By 2015 at the latest, the number of employed persons will begin to fall radically. Those still working will have to support an inordinate number of retirees as life expectancies rise and the population ages."<sup>1</sup>

- Will this combination of an aging, shrinking population force Germany to adopt a more open immigration policy? Will Germany consider easing the barriers to citizenship even for "guest workers" who have been living in Germany for years?

#### **European Union**

1. One of the keys to Germany's success in keeping inflation relatively low (under 3%) has been the tight monetary policy of the Bundesbank, Germany's central bank. Now that the mark has been replaced by the common European currency the Bundesbank can no longer dictate monetary policies.<sup>2</sup>

- What are the prospects for increasing inflation, given the rising Federal deficit and continued subsidies in large areas of the economy in the East? What tools remain to the Government to control inflation without the availability of a strong central bank?

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<sup>1</sup> Martin, p 10

<sup>2</sup> Thompson

2. Government subsidies are needed to attract large investments in the Eastern states, yet such subsidies conflict with European Union guidelines.<sup>3</sup>

- Do you see the growing strength of the EU agencies as an obstacle to the continued development and economic integration of former East Germany? If so, should Germany attempt to change EU policies or just ignore them when necessary and claim that the special circumstances of Germany warrant it?

3. The head of the European Central Bank has singled out Germany's ballooning welfare state as a major reason for the euro's weakness. Some now worry that an unreformed economy like Germany's perhaps shouldn't be sharing the same currency with the euro zone's more dynamic members, like the Netherlands, Spain or Ireland.<sup>4</sup>

- If Europe's largest economy is viewed as a threat to the health of the common currency, should that cause any reevaluation of the desirability of the euro?

4. All of the candidate countries for EU accession have significantly lower per-capita GDPs than the EU average and they all have significant infrastructure problems. These relatively poor countries will likely be net drain on EU resources for several years until their economies improve.

- What are the ramifications of EU expansion for Germany's economy in the short term? Will direct payments to new EU members place an unacceptable burden on German taxpayers? Will an increase in trade with Easter Europe and the

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<sup>3</sup> Thompson

<sup>4</sup> Mann

efficiencies of a common currency offset the costs of subsidizing new EU members?

## **Trade/Globalism**

1. Germany's prosperity has always relied on robust trade. Exports make up 38% of GDP and make it one of the world's largest exporters. This obviously makes Germany's economy very sensitive and vulnerable to foreign and global economic trends.<sup>5</sup>

- Is the continuing phenomena of globalization good for Germany overall? What can Germany do to improve its position in a global market and help minimize its vulnerabilities? Is the continuing integration of European economies good or bad with regard to Europe's ability to compete in a globalized world?

2. Germany's economic activity has traditionally been guided by the principle of the social market economy wherein it supports free trade but controls competition as necessary to preclude negative social costs.

- As globalism continues to stress competitiveness in a global market how will Germany remain competitive while protecting its citizens against some of the negative effects of globalism? If Germany determines its competitiveness is being hurt by its social policies does the government have the will and the means to modify those policies?

## **Inflation/Economic Trends**

1. A Reuters survey of 16 EU countries released in February indicated that Germany was the only country where the economic downturn has not bottomed out. Government

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<sup>5</sup> Thompson

expenditures equal almost 50% of GDP and are rising.<sup>6</sup> The government's annual economic report projected economic growth at a mere .75% while government spending was expected to grow by 1.25%<sup>7</sup>

- Can Germany hope to turn around its current economic condition without cutting government spending and boosting consumer spending?

2. As of February the German economy was officially in recession, following two successive quarters of contraction. GDP shrank 0.3% in the last three months of 2001, following a 0.2% fall between July and September. In December Germany's economy was 0.1% smaller than it had been in December 2000. Growth was zero for 2001, the Federal Statistics Office said. The Statistics Office also said that the budget deficit in 2001 was 2.7% of GDP, up from previous estimates of 2.6% and edging dangerously close to the 3% ceiling imposed by eurozone rules.<sup>8</sup>

- Given the deficit restrictions of the EU Stability and Growth Pact which limits deficits to no more than 3% of GDP how can Germany find the funds for any kind of stimulus package that could help it spend its way out of the current mild recession? Is Germany's economic recovery in the hands of the U.S. economy?

### **Economic Reforms**

Economic reforms have been resisted by unions, businesses, and government agencies. Germany has avoided following the deregulation strategies of the U.S. and U.K. that were instrumental in reviving their economies. German companies have remained

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<sup>6</sup> Mann

<sup>7</sup> F.A.Z., 25 Feb 2002

<sup>8</sup> BBC, 20 February 2002

competitive through subsidies, tax write-offs, government protection against market forces, and by moving outside the country while cutting domestic jobs.<sup>9</sup>

- Is Germany's economic model outmoded? If so, how much longer can current trends continue before Germany slips to the second rank of economic powers? It's been said that in Germany even conservatives are socialists, if so, is there any political will to modify the social economy?

### **Currency/Euro Issues**

In the last quarter of 2001 Germany became the only major industrialized country besides Japan to slip into recession. Unemployment has reached 10.4% and shows no sign of decreasing. Alone among European economies Germany is facing low growth, high unemployment and a growing government deficit. In February Germany narrowly avoided a censure from the EU for allowing its deficit to approach 3% of GDP, failure to rein in spending could result in billions of euros in fines. In the new, integrated European economy Germany's economic problems threaten the entire continent.

- Was the decision to move to a common currency in the best interests of Germany?

### **Government Spending**

This year's budget deficit came very close to exceeding 3% of GDP, the maximum allowed in euro zone under the Stability Pact. Countries that violate the limit may be subject to sanctions.

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<sup>9</sup> Mann

- Does Germany support the concept of sanctions, even if they may be applied to Germany in the future? What has brought the deficit to this level and what should the government do to reverse it? If the only means to reduce the deficit is to reduce social spending is there the popular support and political will to do it?

## **Labor**

1. There is a continuing trend of German companies transferring production facilities to foreign countries, mainly due to high labor costs and taxes. This is a major contributor to the unemployment problem. At the same time foreign direct investment in Germany has been declining.<sup>10</sup>

- What are the long-term implications of these trends, both for employment and tax revenue?

2. German labor costs are among the highest in Europe and workers have the shortest work-week at 35 hours per week, with almost 2 months per year off for vacations and holidays. Social benefits are 50% higher in Germany than in the U.S. Productivity is no longer keeping pace with labor costs and Germany's competitiveness is not commensurate with its rank as a leading exporter.<sup>11</sup>

- Are Germans willing to sacrifice some of their social benefits in order to raise competitiveness? If not, will Germany's unwillingness to adapt to the changing face of global economics threaten to make it another Japan, a country with tremendous economic potential but a stagnant economy? If globalization

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<sup>10</sup> Thompson

<sup>11</sup> Thompson



pressures force German firms to place more emphasis on becoming competitive  
what impact will that have on traditionally peaceful labor relations?

3. Germany's traditionally powerful labor unions have habitually cooperated with both government and industry to keep inflation under control and to minimize strikes, in return for generous worker benefits.<sup>12</sup>

- Union membership has been declining over the last 10 years. Does the declining influence of unions as a socially stabilizing force increase the risk of labor problems that may in turn hurt competitiveness, increase inflationary pressure, and drive more production facilities (and jobs) outside Germany? Is Germany's social compact between labor, government and business threatened by the declining influence of unions? Is there a risk of Germany's labor force becoming radicalized? German society is not used to large-scale labor unrest. Could such unrest spur calls for a stronger government response and undermine support for democratic government, as it did in the Weimar Republic?

4. It is difficult and expensive to lay off workers and German companies must deal with restrictive labor laws dealing with wages and work rules. For this reason, German companies "have over-invested in automation and hired the minimum number of skilled workers at high wages. That only makes sense when you are not trying to eliminate jobs. German firms cut back on their labor force by not employing people."<sup>13</sup>

- Does Germany need to create a new sector of low-wage, low-skilled jobs?

5. The unemployed in Germany enjoy relatively lavish benefits. Those benefits, combined with high taxes on wages remove much of their incentive for looking for work.

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<sup>12</sup> Thompson

<sup>13</sup> Andrews

A 2000 Labor Ministry report showed almost half of the 4 million unemployed were not even looking for work. The Labor Office has resisted competition in its monopoly in job placement services, even though their record is poor (17% success rate). Strict rules make it hard to fire anyone, creating a powerful disincentive for businesses to hire.<sup>14</sup>

- What can Germany do to reduce the unemployment rate? Has longstanding high unemployment resulted in a de-facto permanently unemployed class that is no longer seeking, or even desirous of work? If so, what are the implications for the already aging and shrinking labor pool?

### **Costs of Reunification**

Following unification, the government instituted a 5.5% surcharge on income, wage restraints and revenue sharing in order to pay for the cost of developing the East.<sup>15</sup> More than 11 years after German reunification, the states that once belonged to East Germany are still lagging economically behind the western states. The unemployment rate in January, for instance, was 19.1 percent in the east and 8.3 percent in the west. Eastern Germany has received more than euro 1 trillion (\$870 billion) in aid through 2000.<sup>16</sup>

- How much longer do you foresee these measures will be required? Is there any resentment in the West over these measures? Is it growing? What is the overall impact on Germany's economic outlook?

### **Energy**

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<sup>14</sup> Mann

<sup>15</sup> Thompson

<sup>16</sup> Frankfurter Allgemeine Zeitung, 25 Feb 2002

1. Germany is dependent on energy imports, particularly oil, with per capita consumption continuing to rise.<sup>17</sup> Although coal provides over 1/3 of the country's needs the German coal industry is subsidized since it would otherwise be unable to compete against imported coal. Germany's coal deposits are largely soft brown coal, which is a much greater source of pollution than harder coal.<sup>18</sup>

- Does Germany have plans to increase its use of coal? If so, how will it address the pollution concerns? Will it invest significantly in pollution control technology? If not what are the implications for its relations with its neighbors who will likely suffer more from acid rain than Germany itself?

2. 30% of Germany's electrical power comes from nuclear power plants, all of which are scheduled to be phased out by 2020.<sup>19</sup>

- How will Germany make up the loss of this significant portion of its power generating capacity? Is speculation about the potential for sustainable alternative sources of power, such as solar and wind power, realistic for the energy demands of a nation as large as Germany? If not, what are the implications for the economic health and security of Germany in the years ahead? Will Germany become as dependent on foreign sources of electrical power as it is now for foreign oil? Could the lack of dependable sources of energy accelerate the transfer of production facilities outside Germany, leaving the country as a large version of Hong Kong or Singapore that base their economies on banking and financial transactions and that are totally dependent on imports for all finished goods?

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<sup>17</sup> Thompson

<sup>18</sup> Thompson

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